

# Internal Control Systems

Clerks of the Circuit Court Conference  
June 2014

How many of you can say that you are reasonably certain that the office: operates in a way that goals are reached; reports materially correct information; and materially complies with laws and regulations?

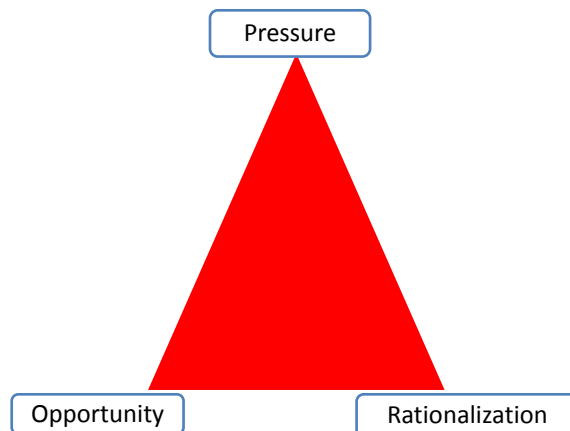
Did the voters that elected you  
think you would do things right?

As a manager, how are you making  
sure?

## Internal controls combat fraud and mistakes

- Prevent Opportunity
- Detect Fraud, Errors and Omissions

### Fraud Triangle



## Why do we talk about internal controls then find it difficult to take action?

- Control systems are not uniform.
- They are not tangible.

They are not rocket science but in order to be effective they have to be more than just thoughts in the mind of management.

## Summary of the Discussion

- Understanding Internal Control
  - 3 Categories of Objectives
  - 5 Components on Internal Control Systems
  - New COSO 2013
    - Expanded guidance on the role of those in charge of governance in Internal Control Systems
    - Adjusted for increased dependence on IT
    - 17 principles under the 5 components
- Implementation

## COSO Definition of Effective Internal Control

An effective system of internal control requires that:

- Each of the 5 components and 17 principles are present and functioning and,
- The 5 components operate together in an integrated manner.

A major deficiency exists if the county cannot conclude that these are met.

## Internal Control Framework (COSO Cube 2013)



## Management's Objectives

- Operations
- Reporting
- Compliance



## Internal Control Components

- Control Environment
- Risk Assessment
- Control Activities
- Information & Communication
- Monitoring Activities



## Control Environment

- Set of standards, processes, and structures
- Tone at the top
- Integrity and ethical values of the county
- Includes performance measures, incentives, and rewards

Acts as the foundation for a sound system of internal control

## Risk Assessment

Risk assessment requires management to consider the impact of possible changes in the external environment and within the county that may render internal control ineffective.

- Many organizations, take a risk-based approach to internal control
- Includes:
  - Risk Identification
  - Risk Analysis
  - Risk Response

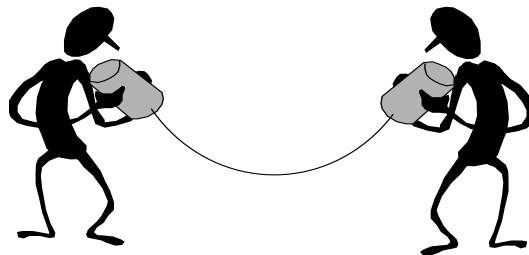
## Control Activities

Control activities are the actions established through policies and procedures to mitigate risks to the achievement of objectives.

- Preventive or detective in nature
- Manual and automated activities
- Includes segregation of duties

## Information and Communication

- Emphasizes importance of quality information
- Volume and sources
- Complexity of processes
- Technology advances
- Greater interaction with 3<sup>rd</sup> party vendors



## Monitoring Activities

### Ongoing Evaluations

- Built into the business process at various levels
- Timely information

### Separate Evaluations

- Conducted periodically
- Frequency will depend on assessment of risks and effectiveness of ongoing evaluations

## New Principles

COSO 2013 Update clarifies requirements for effective internal control with the 17 new principles

- Principles relate to a component of the internal control system
- Not required
- Common sense



## Control Environment

1. The county demonstrates a commitment to integrity and ethical values.
2. Governing boards demonstrate independence from management and exercises oversight of internal control system.
3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities & responsibilities.
4. The county demonstrates a commitment to attract, develop and retain competent individuals.
5. The county holds individuals accountable for their internal control responsibilities.

## Risk Assessment

6. The county specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
7. The county identifies risks to the achievement of its objective across the entity and analyzes risks as a basis for determining how the risks should be managed.
8. The county considers the potential for fraud in assessing risks to the achievement of objectives.
9. The county identifies and assesses changes that could significantly impact the system of internal control.

## Control Activities

10. The county selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
11. The county selects and develops general control activities over technology to support the achievement of objectives.
12. The county deploys control activities through policies that establish what is expected and procedures that put policies into place.

## Information and Communication

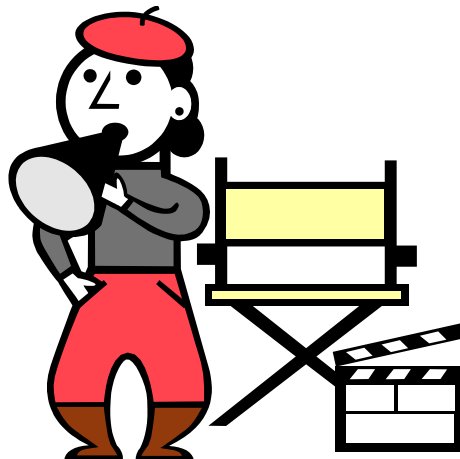
13. The county obtains or generates and uses relevant, quality information to support the functioning of internal control.
14. The county internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of the internal control.
15. The county communicates with external parties regarding matters affecting the functioning of internal control.

## Monitoring Activities

16. The county selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.
17. The county evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the governing boards, as appropriate.

## Implementation

Action!



## Take it Step by Step!

1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information and Communication
5. Monitoring

## Documentation

Start with documenting the 5 components in significant areas first.

- Cash handling
- Management's Goals
  - Customer Service
  - Compliance with Laws and Regulations

## Find where there is risk that is not mitigated by internal control

- This is Risk identification
- Perform your risk analysis
- Respond to the risk
  - Implementing controls
  - Insurance
  - Acceptance of the Risk



## LaGrange Clerk of the Circuit Court

- Charged \$23,253.31
- Cash receipts not deposited
- Transfers to cover the amount of missing cash receipts
- Cash shortages
- Additional Audit Costs
- President of the Clerks Association and named Clerk of the Year just prior to this report being made public

## Switzerland County School Corporation

- Charged Treasurer over \$1.1 million (over 4 years)
- Manually wrote checks to pay personal credit cards
- Used a different check series
- Altered bank statements
- Adjusted disbursement records
- U.S. Attorney charged criminally and civil charges brought by the school

## Ashland Township

- Charged Trustee \$7,860.23
- Consecutive audits reported unsupported disbursements for utilities, travel expenses, office supplies and repairs.
- Other Examination Results and Comments
  - Unapproved salary payments
  - Failure to remit payroll withholdings
  - Failure to provide board minutes for audit
  - Disbursements made in excess of appropriations
  - Late filing of the annual financial report
  - Failure to File 100R
- Certified to Prosecuting Attorney and AG
- Removed from office

## Town of Brownstown

- Charged Clerk Treasurer \$ 393,916.98
- Over paid her salary by \$369,054.70 over 4 years
- Made unauthorized payroll payments to her son for 3 years in the amount of \$22,606.50
- Charged \$2,255.78 for penalties and interest incurred with IRS and IDOR
- Left town during the audit October 2009
- April 2010 sheriff sold her residence under foreclosure order

## Town of North Judson

- Charged Clerk-Treasurer \$ 84,892.67
- Cemetery lot receipts not deposited (required cash)
- Utility receipts not deposited
- Utility customer deposits not receipted
- Ordinance Violations Collections not deposited
- Police Dept receipts not deposited
- Equipment purchased was not at the Town
- Personal expenses paid by Town check
- Paid herself without supporting documentation
- Certified to the AG and Prosecuting Attorney

Are you going to “trust” or “**make sure**” things are done right in your office?